

Alaska Commission on Postsecondary Education

Response to FY17 Budget Intent Language

Evaluation of Loan Servicing Privatization

January 17, 2017

INTENT LANGUAGE

The following intent language was included in the enacted FY17 budget:

It is the intent of the Legislature that the Alaska Commission on Postsecondary Education will develop a plan to privately service the Alaska Student Loan Corporation's remaining loan portfolio and deliver a report to the Finance committees no later than January 17, 2017.

INTRODUCTION

The State of Alaska (State) Legislature established its first loan program for undergraduate students studying at an accredited institution in 1968. The program was funded directly by the State and administered by the State's then-named Department of Education.

The Alaska Commission on Postsecondary Education (ACPE or the Commission) was created in 1974 by an act of the State Legislature. The Commission was created to be the coordinating agency for postsecondary education, to administer student financial aid programs, to coordinate and plan for postsecondary education in the state, as well as to authorize and regulate postsecondary education institutions in Alaska. The education loan programs administered by the Commission were funded by the State. The Commission resides within the Department of Education and Early Development for budgetary purposes but is not subject to the direction of the Commissioner of Education and Early Development or the State Board of Education¹.

The Alaska Student Loan Corporation (ASLC or the Corporation) was created in 1987 by an act of the State Legislature. The Corporation is a public corporation and governmental instrumentality within the Department of Education and Early Development with a legal existence independent of and separate from the State.

The Corporation was created to raise alternative financing for education loans through the issuance of debt to meet the State's goal of providing low-cost education loans to Alaskans pursuing postsecondary education and training, without drain on the State's General Fund. By statute the Corporation has one employee, the Executive Officer. The employees of the Commission serve as staff for the Corporation.

The Corporation funds the Commission's expenditures as permitted by ASLC statutes and bond indentures. The Corporation cannot be terminated as long as it has debt outstanding. Under contract with the Corporation, the Commission awards and services the Corporation's education loan portfolio. Additional information is available at acpe.alaska.gov.

¹ Alaska Statute 14.42.040(b)

HISTORY

ACPE has a long history of making changes and privatizing services when doing so is cost-effective and does not have negative impacts on customers. Over the last several years, several changes to privatize services historically performed by ACPE staff have occurred and significant cost savings were achieved as a result. A primary goal driving the State's creation of ACPE and ASLC was providing Alaska students with the lowest possible cost education loans, in a way that was sustainable, but without drain on the State's General Fund. To that end, ASLC's education loan interest rates are set based on program costs, with any cost savings translating into lower interest rates or cost reductions on education loans. Recent cost savings have resulted in stable interest rates and borrower benefits, and have enabled ACPE to absorb approximately \$1 million in budget reductions in the last three years.

Following is a summary of the services privatized in recent years:

- Collection vendor services –education loan collection vendor performs collection services at no cost to the commission. The vendor is paid for services through fees collected from defaulted borrowers
- Letter and imaging services – (annual savings of > \$40,000)
- Loan servicing related to ASLC's allocation of Federal Direct Student Loan Program loans (FDSLP) as a non-profit lender – FDSLP loans allocated to ASLC are outsourced for servicing to MOHELA (annual revenue of \$220,000)

In addition to privatizing services when appropriate, ACPE adopted the Lean continuous improvement model in 2015 and as a result of process improvements and other changes, has saved approximately \$110,000 since implementation.

APPROACH TO RESPONSE

As part of developing the current analysis, ASLC contacted and obtained from its financial advisor, First Southwest, third party expert advice and assessment of the draft report and privatization plan. First Southwest provided a letter describing the outcome of its review, which is incorporated into this report (see [Appendix A](#)).

The intent language requests ACPE to develop a plan to privately service the ASLC loan portfolio. The Legislature has periodically directed the Commission to provide information on the costs and benefits of privatization, beginning in 1983, with the results from early research being a significant factor in the creation of ASLC to ensure the sustainability and availability of the loan program to Alaska students. A history of this direction and associated responses is provided as [Appendix B](#) to this report.

The issue of privately servicing ASLC loans is complex and involves considerations from many perspectives, including legal, financial and political implications. To inform the current report, ACPE identified the following key implications:

Legal

- Debt and trust covenants and obligations
- Terms and conditions of education loan promissory notes
- Potential transferability to a private party of ACPE's statutory administrative collection authorities (garnishment of wages or Permanent Fund Dividends, access to state databases for skip tracing, etc.)
- Statutory administrative due process rights afforded to borrowers
- Family Federal Education Loan Program (FFELP) servicing requirements

Financial

- Costs and/or savings from private servicing
- Costs of rating agency confirmations and any changes to ASLC credit rating
- Costs to obtain credit enhancement provider's approval to replace existing loan servicer
- Impact to ASLC's reputation with investors and future debt issuance costs if debt ratings are lowered as a result of changing the existing loan servicer
- ASLC's ability to continue providing financial support to ACPE for management of non-ASLC funded programs (servicing non-ASLC loan programs, WWAMI, Alaska Performance Scholarship, Alaska Education Grant, etc.), totaling \$490,000 in FY16

Political

- Public perception of servicing Alaska assets out-of-state (currently no private student loan servicers in Alaska)
- Monitoring and compliance oversight of servicing and management of Alaska assets (ASLC as lender cannot transfer its compliance responsibility to a private servicer and remains liable for any non-compliance)
- Changes in quality of servicing if Alaska loans are serviced by a national vendor without an Alaska nexus

Identification of these key financial, legal and political implications of privately servicing Alaska education loans created a foundation from which we were able to identify high level cost/benefit information. Following is a table of the major pros and cons of privatizing ACPE's servicing of ASLC loans.

MAJOR PROS	MAJOR CONS
<ul style="list-style-type: none"> • Private sector has extensive student loan servicing experience and could service very efficiently • Potential reduction in some servicing costs • There may be financial institutions interested enough to consider entering student loan servicing market • Potential reduction in number of state employees 	<ul style="list-style-type: none"> • Loss of flexibility and speed in implementing public policy-driven program changes • Need to identify structure, staffing and funding for services currently provided by ACPE but funded by ASLC (WB loan servicing, outreach, WWAMI, APS, AEG, etc.) • Potential movement of Alaska jobs and management of Alaska assets out-of-state if no Alaska servicer identified • Potential reduction in Alaska-specific quality of servicing and customer satisfaction (strong public and institutional value of ACPE servicing) • Complexity and cost of contract management, especially if required periodic rebidding results in a change of servicer • Complexity and cost of securing rating agency and credit provider approvals • Costs associated with converting loans onto a different servicing platform

ACPE has approached this project from a broad-view perspective as an opportunity to assess our cost-savings and privatization efforts to date, and to identify where there may be additional opportunity for cost reduction through privatization. To that end, our goal is not only to provide the reports as requested but also to look for options that may enhance our ability to reduce costs and pass those savings to student borrowers, such as outsourcing specific processes rather than wholesale outsourcing of the entire servicing spectrum. Exploring ways to more efficiently develop and/or deliver higher education access products and services for Alaskans is a critical component of ACPE's continuous improvement processes. However, gathering the appropriate information and conducting the necessary analysis will take some time and will not be without cost. It is ACPE's intent to ensure full responsiveness to the Legislature's direction by documenting information needed and decision points, to create a thorough and well-researched evaluation that will inform next steps related to ASLC loan servicing.

Since this report to the Legislature is due January 2017, it is not feasible to complete the analysis and report to the Finance Committees by the deadline provided in the intent language. ACPE has therefore developed a comprehensive plan and timeline for evaluating the costs and benefits of having ASLC's loan portfolio privately serviced. The plan includes evaluating costs and benefits as they apply to the entire portfolio, as they apply separately to the federally guaranteed portfolio and the state portfolio, and as they apply to individual components of portfolio servicing.

PRIVATIZATION PLAN DEVELOPMENT

Plan Activity and Key Decision Points	Projected Timeframe
Identify other states using private servicers	Complete as of August 2016
Identify scope of private servicing available	
Consult with financial advisor and bond counsel to determine if/when the federal loan portfolio can be sold given the limitations associated with the financing of those loans. <i>ASLC's financial advisor determined the bond documents prohibit the sale of the portfolio until certain conditions are met; ASLC does not anticipate meeting these requirements until 2021 (see Appendix A)</i>	
Gather information/guidance from other state and non-profit lenders using private servicers	June 2016 - March 2017
Gather information from student loan servicing providers	
Meet with potential vendors to discuss possible options and determine next steps	
DECISION POINT 1: Identify costs and contracts/approvals needed to privatize portfolio servicing	
Determine cost associated with servicing non-ASLC loans and identify funding source if no longer serviced by ACPE	February 2017 – January 2018
Identify responsible party for overseeing non-ACPE servicing for non-ASLC programs	
Determine costs associated with federal loan portfolio (FFELP loans) servicing and conduct servicing analysis to determine if servicing includes meeting required reporting needs	
Determine costs associated with non-federal ASLC loan portfolio servicing and conduct servicing analysis including meeting required reporting needs	
Determine loan servicers qualified and willing to service ASLC's federal loan portfolio	

Plan Activity and Key Decision Points	Projected Timeframe
Identify loan servicers qualified and willing to service ASLC's non-federal loan portfolio	
Determine costs/benefits of one external servicer to service all ASLC loans or different servicers for different portfolios	
Determine process and cost associated with obtaining the ASLC Letter of Credit provider's approval to replace the current servicer for loans pledged to the 2012 bonds	
Determine cost of obtaining rating agency confirmations associated with replacing the current loan servicer on loans pledged to the 2013 floating rate note	
Determine level of staff and costs associated with monitoring third party servicers to ensure compliance and reporting requirements are being met to minimize the risk of losing the guarantee on FFELP loans, or experiencing liabilities or an increase in non FFELP loan defaults	
ACPE and ASLC strategic planning and next steps related to impacts and associated plans	
DECISION POINT 2: Determine how to finance next steps	
Evaluate statutes and regulations to determine what changes need to be made to facilitate privatizing of loan servicing	January – March 2018
Determine if funding is needed to identify viability and costs of privatization	
Obtain funding if necessary	
DECISION POINT 3: Determine if statutory or contractual changes are needed	
Determine up-front/conversion costs to transfer portfolio to private party	March – July 2018
Consider impact on existing contractual relationships and obligations and allowable timing for changes	
Develop conversion timelines	
HIGH LEVEL IMPLEMENTATION PLAN	
Request funding	August 2018 – December 2019
Develop and deploy conversion project team	
Initiate necessary conversion activities	
Promulgate regulation changes	
Develop and deploy compliance oversight model	
Privatization completed	January 2020

Having identified the scope of privatization of ASLC's portfolio, we identified options for next steps.

OPTIONS FOR NEXT STEPS AND RECOMMENDATION

1. Given assumed costs and complexity associated with wholesale privatization, defer action:
 - a. Indefinitely
 - b. Pending analysis of demand for new loans and impact on portfolio
2. Estimate costs and request funding to facilitate review and evaluation needed to make an informed decision
3. Continue with ongoing incremental analyses and privatization of servicing components when it results in savings.

Based on the analysis completed as part of preparing this report, we respectfully recommend focusing on the third option at this time: incremental privatization where appropriate. A wholesale privatization of servicing the ASLC portfolio would be very costly to accomplish, and would require expensive expert analyses, rating agency confirmations, credit and liquidity provider approvals, and any necessary statutory changes. Detailed discussion of these requirements is included in the reports from previous privatization research (see [Appendix B](#)). Furthermore, given the relatively small size of ASLC's portfolio and the number of unique loan terms and conditions included in the promissory notes, the likelihood of any significant cost savings from privatization is low. Last, ASLC is currently experiencing significant change in its portfolio composition, with a rapid decline in the FFELP portfolio, recent changes to State loan limits and terms resulting in increased origination volume, and the ongoing internal and external loan refinancing. With this level of change in the portfolio composition, it will be challenging to secure valid assessments.

Those costs and complexities so noted, it is appropriate to take action to reduce costs through privatization whenever possible, and doing so is a key piece of ACPE's Lean continuous improvement initiative. Therefore, we do not recommend option one or option two but focus instead on option three.

The third option provides for privatization to occur incrementally as the potential for cost savings is identified, without incurring high costs in order to leverage those benefits of privatization. To date, this option has resulted in ACPE being able to absorb approximately \$1M in budget reductions over the past three years, a decrease of six FTEs while still absorbing the management of the Alaska Performance Scholarship and Alaska Education Grant programs, and the deletion of an additional six PCNs (and associated budget) in FY18, for a total 11.5 percent decrease in

positions. Moreover, pursuing this option at this time in no way precludes pursuing a full privatization at some future date.

The Alaska Commission on Postsecondary Education and its staff thank the Legislature for this recent opportunity to evaluate the pros, cons, and costs of privatizing the servicing of ASLC education loans; and we look forward to our continued partnership with Alaska's policy leaders and advocates in providing low-cost access to the benefits of higher education and career training for all Alaskans, with no drain on the State's General Fund. We look forward to feedback from the Legislature relative to this report.

APPENDICES

[Appendix A - Letter from ASLC Financial Advisor on Privatization](#)

[Appendix B – Historic Privatization Research](#)